

Oversight Division

Committee On Legislative Research

**Missouri Housing Development
Commission
(MHDC)**

Program Evaluation:

Missouri Housing Development Commission (MHDC)

*Prepared for the Committee on Legislative Research
by the Oversight Division*

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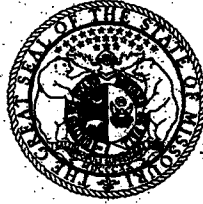
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STATE CAPITOL
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February 27, 2002

Members of the General Assembly:

The Joint Committee on Legislative Research adopted a resolution in May, 2001, directing the Oversight Division to perform a program evaluation of the Missouri Housing Development Commission to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation.

The accompanying report includes Oversight's comments on internal controls, compliance with legal requirements, management practices, program performance and related areas. We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates.

Respectfully,

A handwritten signature in cursive script that reads "Larry Rohrbach".

Senator Larry Rohrbach
Chairman

EXECUTIVE SUMMARY

The Missouri Housing Development Commission (MHDC) was established by the 75th General Assembly in 1969. Since that time, MHDC has encouraged and assisted in the production of affordable rental housing and provided homeownership opportunities for thousands of families. The Mission of MHDC remains to provide quality, safe, affordable housing for low and moderate income citizens of Missouri.

The Commission's programs have resulted in the investment of almost \$4 billion in Missouri housing, covering every county in the state, for rental housing developments, home mortgages, home improvement loans, loans to landlords for renovations, grants to neighborhood housing groups, and other programs.

Oversight has concluded that the state housing tax credit is so heavily discounted in multifamily housing development that its effectiveness in producing additional housing construction can not be documented. We have recommended the General Assembly consider the high cost of this tax credit program with the benefits to be achieved.

Oversight has also concluded that MHDC has developed a comprehensive set of procedures to ensure the financial safety and stability of multifamily housing projects. Those developers who propose multifamily projects for MHDC financing must provide documentation of their experience in multifamily housing as well as the financial stability to ensure the project's completion. These requirements create significant barriers to new developers and contractors. Oversight noted that most of the development funding was provided to a limited number of larger contractors, and that syndication of the tax aspects related to those multifamily developments was done by an even smaller number of specialists. In an effort to reduce the negative impact of these barriers, MHDC has provided technical assistance and training for potential new developers, and has arranged for experienced developers to work with community organizations which want to develop a multifamily project.

Oversight believes that MHDC has accumulated excessive amounts of cash and investments. We noted that MHDC has invested significantly less of its outstanding mortgage revenue bonds into residential loans than comparable housing finance agencies in the region. In addition, MHDC appears to have accumulated significant fund balances from successful operations. Although the fund balance is being used to further MHDC's objectives in providing additional homeownership opportunities for lower income families, the size of the fund balance may indicate that MHDC charges more than its cost of operations. State law limits MHDC charges to the cost of providing the related services.

Finally, Oversight noted that MHDC does not retain applications for multifamily projects which are not approved and do not receive MHDC funding. As a result, Oversight was unable to determine the significant differences between approved and unapproved projects. Retention of documentation supporting agency decisions is essential in defending against claims of improper decisions, as well as allowing audit work to be performed. In our review, we became aware that many but not all housing finance agencies retain documents for unfunded project proposals.

Oversight Division wishes to thank the MHDC staff for their cooperation and assistance during the evaluation.

A handwritten signature in black ink that reads "Mickey Wilson". The signature is written in a cursive, flowing style.

Mickey Wilson, CPA
Acting Director

Chapter 1 - Introduction

PURPOSE

The General Assembly has provided by law that the Committee on Legislative Research may have access to and obtain information concerning the needs, organization, functioning, efficiency and financial status of any department of state government or of any institution that is supported in whole or in part by revenues of the state of Missouri. The General Assembly has further provided by law for the organization of an Oversight Division of the Committee on Legislative Research and, upon adoption of a resolution by the General Assembly or by the Committee on Legislative Research, for the Oversight Division to make investigations into legislative and governmental institutions of this state to aid the General Assembly.

The Committee on Legislative Research directed the Oversight Division to perform a program evaluation of the Missouri Housing Development Commission for the purpose of providing information to the General Assembly regarding proposed legislation and appropriation bills.

BACKGROUND

The Missouri Housing Development Commission (MHDC) was established by the 75th General Assembly in 1969. The Commission does not build or renovate housing; rather, it functions more like a bank, providing financing directly to borrowers or through a network of private lending institutions. The Mission of MHDC remains to provide quality, safe, affordable housing for low and moderate income citizens of Missouri.

MHDC programs have resulted in the investment of almost \$4 billion in Missouri housing, covering every county in the state, for rental housing developments, home mortgages, home improvement loans, loans to landlords for renovations, grants to neighborhood housing groups and other programs.

Single-family Homeownership Loan Program

The Commission operates several programs to provide assistance to homebuyers, especially first-time homebuyers and those who are purchasing homes in rural Missouri. Participation in the programs is limited to homebuyers who have lower incomes yet still qualify for a home loan. Further, the price of the home is limited. MHDC loans are processed by participating lenders and may be a conventional loan product, or may be combined with USDA Rural Development, Veterans Administration, Fannie Mae, or U.S. Housing and Urban Development products. MHDC relies on real estate professionals and lenders throughout the state to provide information on its programs to qualified first-time and special category homebuyers. The Commission provides training for real estate professionals and lenders to keep them up to date on MHDC Homeownership programs, policies and procedures.

MHDC sells mortgage revenue bonds periodically through the year, and loans are available up to the amount of bond proceeds after each issue. In a commitment to the enhancement of rural housing development, the Commission has committed fund balances, when necessary, to ensure that funds are available 365 days a year for rural homebuyers. MHDC offers a loan product, also using its fund balances, with a special Cash Assistance Payment to cover down payment and closing costs at a slightly higher interest rate. In addition, the Commission cooperates with other agencies that provide down payment assistance in specific geographic areas and to developmentally disabled persons.

The Commission has also developed a program to stimulate the construction of new housing stock in the six counties of the Missouri Bootheel. Qualified applicants may be advanced 20 percent of the purchase price as a second mortgage at 0 percent interest, provided the first mortgage is a U.S. Department of Agriculture/Rural Development Direct Homeownership Loan.

Multifamily Rental Housing Production Program

The MHDC Rental Housing Production and Preservation Program provides below market interest rate construction and permanent financing to developers for the acquisition and rehabilitation, or new construction, of multifamily rental housing for low and moderate income families. It is the intent of the Commission to serve the greatest housing needs in the state and the lowest income tenants in those areas of greatest need.

MHDC is the state agency designated to distribute federal and state tax credits for low income housing. The Low Income Housing Tax Credit (LIHTC) program provides the developer of a multifamily rental property with a specific amount of credit against state and federal income taxes, respectively. The amount of tax credit granted to an individual project is based on the qualified cost of the development; a planned development is allowed an estimated amount of tax credits based on budgeted costs submitted by the developer. The actual eligible costs are determined at the completion of construction, and any excess credit amounts are returned to MHDC for reallocation.

The Commission is required to publish a Qualified Allocation Plan (QAP) each year, to establish its funding priorities. The QAP provides geographic and economic balance in funding proposals, and ensures the selection of those developments that serve to address the most pressing housing needs of the state, within the guidelines and requirements established by the Federal Government. Each year the Commission sends out a Notification of Funding Availability (usually in August) for organizations and developers to submit funding requests for the construction and preservation of affordable housing units.

A development which receives low income housing tax credit financing must serve a designated percentage of low income tenants. To create housing units capable of serving the lowest income individuals, a development must often be financed with a combination of tax credits (federal and state), low interest loans, and rental assistance. Applicants may use the tax credit in

conjunction with private financing, or may obtain loans from one or more of the MHDC low interest rate loan programs.

Developers may be for-profit or not-for-profit organizations. Applicants must demonstrate prior successful multifamily housing experience and must engage the services of qualified professionals such as architects, appraisers, attorneys, accountants, building contractors, and property managers. Developers must demonstrate the financial and management capability to successfully complete and operate the proposed development. In order to be considered for MHDC funding, proposed housing developments must also:

- Meet a demonstrated affordable housing need;
- Provide housing for low and moderate income persons and families;
- Have documented local support;
- Leverage MHDC funds with tax credits, other equity and/or rental assistance, and;
- Be economically feasible.

The Commission favors those developments which commit to the longest periods of affordability. Tax credit financing includes a requirement that the development serve low-income tenants for 15 years. When tax credits and MHDC low-interest-rate loans are employed in financing a development, the affordability period is extended to the term of the loan, which in most cases is 30 years. Certain projects are permanently dedicated to affordability by contract and deed restriction.

OBJECTIVES

The program evaluation of MHDC included interviews with MHDC staff and the inspection of records for the purpose of providing information to the General Assembly for their consideration in proposing legislation and reviewing appropriation bills. The objectives of the Oversight Division's evaluation of MHDC included determining the amount of total state tax credits being authorized and utilized, the amounts of matching federal grants, how projects are chosen for funding, the internal criteria for approving projects to receive tax credits, the distribution of tax credits throughout the state, the historical distribution of the credits, and whether some developers are shown preference over others when applying for the credit.

SCOPE

The scope of our evaluation included the time period from July 1, 1997 to June 30, 2001. Our scope was not limited to specific fiscal years, although for most analyses, data from fiscal years 1998 through 2000 was utilized.

METHODOLOGY

Our evaluation included interviewing MHDC personnel, reviewing a sample of project files, examining data provided by MHDC, and comparing MHDC information with information provided by other state housing finance agencies and statistics compiled for other states by the National Council of State Housing Agencies.

Chapter 2 - Charts

Chart 1 Low Income Housing Tax Credits Issued and Housing Constructed

The United States Internal Revenue Service (IRS) allocates money to every state based on their population. For years 1998, 1999 and 2000, this allocation of IRS tax credits was based on a ratio of \$1.25 per capita. Therefore, Missouri's federal tax credit totals were approximately \$6.75 million per year. The allocation was raised for fiscal year 2001 to \$1.50 times the population, increasing the distribution to approximately \$8.4 million. The level of funding increases to \$1.75 times per capita in 2002, and beginning in 2003, the annual allocation will be adjusted for inflation.

In 1990, the State of Missouri began supplementing the federal program by allocating state income tax credits equal to 20 percent of the federal total. In 1994, the state tax credit was increased to 40% of the federal credit for the following three years, to aid in replacing housing lost in the flood of 1993. In 1997, the state tax credit was increased to as much as 100 percent of the federal tax credit, increasing available funding as well as the number and size of projects that can be funded.

The following is a summary of the number of low-income housing units built or to be built in Missouri with the assistance of the state and the federal low-income housing 9 percent tax credits.

9% Credits

<u>Year</u>	<u>Total Number of Units</u>	<u>Number of Low Income Units</u>	<u>Annual allocation of Federal 9% LIHTCs</u>	<u>Annual allocation of State 9% LIHTCs</u>
1998	1,387	1,335	\$ 6,827,811	\$ 6,631,856
1999	1,232	1,084	\$ 6,845,744	\$ 6,803,469
2000	1,218	1,218	\$ 6,942,374	\$ 6,935,315
2001	1,464	1,448	\$ 8,424,648	\$ 8,398,648

4% Credits

<u>Year</u>	<u>Total Number of Units</u>	<u>Number of Low Income Units</u>	<u>Annual allocation of Federal 4% LIHTCs</u>	<u>Annual allocation of State 4% LIHTCs</u>
1998	1,534	1,286	\$ 1,563,854	\$ 1,503,695
1999	3,102	3,020	\$ 2,831,200	\$ 2,622,837
2000	671	631	\$ 1,110,269	\$ 1,110,269
2001	1,716	1,716	\$ 4,228,482	\$ 3,160,118

Chart 2 Low Income Housing Tax Credits by Region

Chart 2a shows Federal and State Tax 9% Credits issued from 1998 through 2000 by MHDC region. These credits are allocated by region according to the Qualified Allocation Plan (QAP) and awarded directly to developers by MHDC, based on the MHDC staff assessment of the relative desirability of plans development submitted by the developers.

Chart 2b shows Federal and State 4% credits issued from 1998 through 2000 by MHDC region. These credits are available to developers on application to the Missouri Department of Economic Development. MHDC staff review the applications, and advise the Department of Economic Development, but these credits are not subject to the QAP. These credits are awarded from a pool of general tax credits available to the state, and not from the state's 9% housing credit allocation.

Chart 2a

Missouri Housing Development Commission
9% Tax Credits (Competitive) Allocated by Region
For years 1998 through 2001

1998 Low-Income Housing Tax Credit

	<u>Federal</u>	<u>State</u>	<u>Total</u>	<u>Percentage</u>
Kansas City	\$ 1,733,805	\$ 1,723,239	\$ 3,457,044	25.7%
St. Louis	\$ 2,041,850	\$ 1,940,052	\$ 3,981,902	29.6%
Southeast	\$ 759,392	\$ 752,527	\$ 1,511,919	11.2%
Southwest	\$ 1,425,217	\$ 1,370,833	\$ 2,796,050	20.8%
North Central	\$ 867,547	\$ 845,205	\$ 1,712,752	12.7%
Totals	\$ 6,827,811	\$ 6,631,856	\$ 13,459,667	100.0%

1999 Low-Income Housing Tax Credit

	<u>Federal</u>	<u>State</u>	<u>Total</u>	<u>Percentage</u>
Kansas City	\$ 1,413,524	\$ 1,413,524	\$ 2,827,048	20.7%
St. Louis	\$ 2,083,326	\$ 2,064,121	\$ 4,147,447	30.4%
Southeast	\$ 820,874	\$ 820,581	\$ 1,641,455	12.0%
Southwest	\$ 1,370,204	\$ 1,357,861	\$ 2,728,065	20.0%
North Central	\$ 1,157,816	\$ 1,147,382	\$ 2,305,198	16.9%
Totals	\$ 6,845,744	\$ 6,803,469	\$ 13,649,213	100.0%

2000 Low-Income Housing Tax Credit

	<u>Federal</u>	<u>State</u>	<u>Total</u>	<u>Percentage</u>
Kansas City	\$ 1,358,513	\$ 1,351,454	\$ 2,709,967	19.5%
St. Louis	\$ 2,676,848	\$ 2,676,848	\$ 5,353,696	38.6%
Southeast	\$ 974,609	\$ 974,609	\$ 1,949,218	14.0%
Southwest	\$ 996,704	\$ 996,704	\$ 1,993,408	14.4%
North Central	\$ 935,700	\$ 935,700	\$ 1,871,400	13.5%
Totals	\$ 6,942,374	\$ 6,935,315	\$ 13,877,689	100.0%

2001 Low-Income Housing Tax Credit

	<u>Federal</u>	<u>State</u>	<u>Total</u>	<u>Percentage</u>
Kansas City	\$ 1,436,641	\$ 1,436,641	\$ 2,873,282	17.1%
St. Louis	\$ 3,004,881	\$ 3,004,881	\$ 6,009,762	35.7%
Southeast	\$ 971,642	\$ 971,642	\$ 1,943,284	11.6%
Southwest	\$ 1,638,343	\$ 1,638,343	\$ 3,276,686	19.5%
North Central	\$ 1,373,141	\$ 1,347,141	\$ 2,720,282	16.2%
Totals	\$ 8,424,648	\$ 8,398,648	\$ 16,823,296	100.0%

Chart 2b

Missouri Housing Development Commission
4% (Non-competitive) Tax Credits by region
For years 1998 through 2001

1998 Low-Income Housing Tax Credit				
	Federal	State	Total	Percentage
Kansas City	\$ 327,609	\$ 308,215	\$ 635,824	20.7%
St. Louis	\$ 967,289	\$ 767,289	\$ 1,734,578	56.5%
Southeast	\$ -	\$ -	\$ -	0.0%
Southwest	\$ 149,872	\$ 309,107	\$ 458,979	15.0%
North Central	\$ 119,084	\$ 119,084	\$ 238,168	7.8%
Totals	\$1,563,854	\$1,503,695	\$3,067,549	100.0%

1999 Low-Income Housing Tax Credit				
	Federal	State	Total	Percentage
Kansas City	\$ 532,258	\$ 532,258	\$ 1,064,516	19.5%
St. Louis	\$2,058,942	\$1,850,579	\$3,909,521	71.7%
Southeast	\$ -	\$ -	\$ -	0.0%
Southwest	\$ 240,000	\$ 240,000	\$ 480,000	8.8%
North Central	\$ -	\$ -	\$ -	0.0%
Totals	\$2,831,200	\$2,622,837	\$5,454,037	100.0%

2000 Low-Income Housing Tax Credit				
	Federal	State	Total	Percentage
Kansas City	\$ 781,209	\$ 781,209	\$ 1,562,418	70.4%
St. Louis	\$ 69,806	\$ 69,806	\$ 139,612	6.3%
Southeast	\$ -	\$ -	\$ -	0.0%
Southwest	\$ 108,880	\$ 108,880	\$ 217,760	9.8%
North Central	\$ 150,374	\$ 150,374	\$ 300,748	13.5%
Totals	\$1,110,269	\$1,110,269	\$2,220,538	100.0%

2001 Low-Income Housing Tax Credit				
	Federal	State	Total	Percentage
Kansas City	\$2,296,203	\$1,946,203	\$4,242,406	57.4%
St. Louis	\$1,569,364	\$ 851,000	\$2,420,364	32.8%
Southeast	\$ -	\$ -	\$ -	0.0%
Southwest	\$ 102,191	\$ 102,191	\$ 204,382	2.8%
North Central	\$ 260,724	\$ 260,724	\$ 521,448	7.1%
Totals	\$4,228,482	\$3,160,118	\$7,388,600	100.0%

Chart 3 Single Family Loan Program

MHDC sold Mortgage Revenue Bonds as follows, for the years ending June 30,

2001	\$258,095,000
2000	\$361,925,000
1999	\$302,994,000
1998	\$274,034,000
1997	\$196,191,000

MHDC made or purchases single-family home loans as follows, for the years ending June 30,

2001	\$247,260,000
2000	\$309,566,000
1999	\$202,504,000
1998	\$265,816,000
1997	\$198,022,000

CHAPTER 3 - COMMENTS

Comment: MHDC project development opportunities appear to be limited to developers with previous experience in the state.

MHDC-financed multifamily housing rental housing properties been developed by a limited number of developers, and the syndication of tax credits is even more concentrated. MHDC managers told us they have developed confidence in experienced developers' ability to meet all of the requirements and still keep a development moving forward. However, Oversight believes the concentration of projects into fewer developers could result in fewer projects at higher cost to MHDC.

A new developer should stand a good chance of having a project approved, if that developer were willing to spend the time to become proficient at the special requirements for MHDC projects, obtain adequate financial backing, and present a good project for funding consideration. In an effort to provide opportunities to more developers, MHDC has worked with community organizations to help them develop technical proficiency, and partnered them with successful developers to enhance their practical ability to manage projects. Several community organizations have then gone on to develop their own projects. MHDC managers told us they will also work directly with developers and even provide technical support in an effort to improve the quality of proposals and paperwork submitted.

We understand from discussions with MHDC managers that the technical requirements and capitalization needs for multifamily projects can create difficulties for inexperienced developers. The consequences of project failure are severe including the loss and recapture of federal tax credits, and extremely serious federal income tax problems due to the potential for recapture of depreciation deductions. It is worth noting that another state, with a housing finance agency that places less emphasis on project management and developer selection, has had approved projects fail even before construction could begin, and as a result has allowed part of its federal tax credit allocation to be returned to the national pool of unused credits. MHDC has not had this issue with projects

underwritten by its staff, and has in fact been able to utilize other states' lapsed credits.

Oversight recommends MHDC continue to work toward opening development opportunities to more contractors.

Comment : MHDC is using most of its proceeds from tax exempt bonds for investment in securities rather than funding for loans.

As shown on Schedule 3 in Chapter 2, MHDC initially invested substantially all of its bond issue proceeds into residential loans. In our review of MHDC financial statements, however, we noted that only 22.7% of MHDC outstanding tax-exempt bond debt remained invested in residential loans, and 77.3% of its tax-exempt bond debt outstanding was invested in marketable securities. Other states in the region maintain substantially all of the proceeds from tax exempt bond sales in residential loans. In overall terms, MHDC appears to have too much of its bond debt outstanding invested in securities.

MHDC managers said that investments are used for several purposes. Bond proceeds are invested in securities between the closing of the bond sale and the disbursement of residential loans. In addition, amounts received in payment of interest and principal on residential loans are invested in securities until needed to make interest and principal payments on outstanding bonds. These practices are essential and prudent, and Oversight assumes the large investments in securities result from the following factors.

Bond sales and home loans are relatively long-term arrangements. Home loans can be paid off through refinancing or home sales. Depending on market conditions at the time bonds were issued, some MHDC bonds may be redeemed early by MHDC and some may not. Thus, interest rate changes and other market fluctuations during the life of these obligations can create a mismatch between the planned maturities and the actual lives of the obligations. Due to declining interest rates over the past few years, MHDC has had a lot of single-family loans refinanced. Those homeowners generally could not refinance with an MHDC loan because they were no longer first-time homebuyers. In addition, MHDC has had a significant amount of loans mature, and has received extra principal payments on some of its loans. All of these

factors would tend to create an accumulation of extra cash at MHDC.

The MHDC authorizing statute, Section 215.030(20) RSMO, allows the Commission “to borrow money to carry out and effectuate its purpose and to issue its negotiable bonds or notes as evidence of any such borrowing in such principal amounts and upon such terms as shall be necessary to provide sufficient funds for achieving its purpose, and to secure such bonds or notes by the pledge of revenues, mortgages or notes of others”. Section 215.030(9) RSMO, further allows the Commission “to invest any funds not required for immediate disbursement in obligations of the state of Missouri or of the United States government or any instrumentality thereof, the principal and interest of which are guaranteed by the state of Missouri, or the United States government or any instrumentality thereof, or bank certificates of deposit, or, in the case of funds pledged to note or bond issues of the commission, in such investments as the commission may determine...”

MHDC managers told us they pay off bonds early when feasible. Until the bonds are called, repaid, or defeased, MHDC invests this money in securities. MHDC has generated considerable investment income because of its investments in securities. Some of the excess must be paid to the United States Treasury in compliance with the federal arbitrage law. Most of the excess is retained by MHDC.

Oversight recommends MHDC continue to work toward managing sales of bonds and a combination of repurchase/call/defeasance procedures to reduce the amount of excess cash/investments on hand.

Comment : The Commission’s large fund balances suggest its charges have been exceeding its costs and should be reduced.

MHDC has accumulated a fund balance of some \$287 million. Of this, some \$7 million is restricted by state law, \$59 million is restricted by bond resolution, and another \$193 million is restricted by the Commission. The amounts restricted by bond resolution and state law are not subject to change by MHDC, but the amounts restricted by the

Commission are primarily designations for MHDC programs and are available for MHDC use.

Section 215.030(8) allows the commission “to collect reasonable fees and charges in connection with making and servicing its loans, notes, bonds, obligations, commitments, and other evidences of indebtedness, and in connection with providing technical, consultative and project assistant services. Such fees and charges shall be limited to the amounts required to pay the costs of the commission, including operating and administrative expenses, and reasonable allowances for losses which may be incurred.”

MHDC managers told us they have built these reserves over 30 years and that the bond markets prefer, and give better interest rates to organizations which demonstrate “profitability and stability”. Accordingly, having larger MHDC fund balances can result in lower net costs to MHDC borrowers.

The fund balances are used to further several MHDC programs . The availability of these reserves, together with the availability of significant amounts of cash and marketable securities, enables MHDC to provide low-interest and no-interest loans for specific identified housing needs. However, the magnitude of the fund balances, most of which are restricted only by Commission resolution, indicate that MHDC has not limited its charges to “the costs of the Commission” as required by state law.

Oversight recommends MHDC consider reducing charges and margins on its products.

Comment : The Commission discards records which could document their decisions.

MHDC staff rank proposed projects into three categories: Funded, Fundable, and Rejected.. Funded projects are fully approved and selected for MHDC funding, fundable projects met MHDC requirements but were considered less desirable than funded projects, and rejected projects were those which did not meet MHDC requirements. MHDC does not retain any information for Fundable and Rejected projects other than names of projects and organizers.

Good business practices require a record retention system which will document support for management decisions. Failure to retain records makes a defense against a legal challenge difficult, and also reduces audit effectiveness. A South Carolina review indicated that although South Carolina's HFA did not retain rejected project files, other states in their region did.

Without documentation of the attributes of Fundable and Rejected projects, it would appear that MHDC would be more subject to second guessing, since documentation for rejected projects could be changed by developers. Further, review of MHDC programs by auditors is impossible without examples of unapproved projects' shortcomings.

Oversight recommends MHDC retain documentation for all projects submitted. The files could be archived or stored, but retention of the documentation might better support MHDC decisions and would allow audits.

Comment : State Tax Credits for low income housing appear to have little effect on the program while costing the state a rapidly increasing amount of tax revenue.

Oversight found that the amount of housing tax credits issued by the Missouri Housing Development Commission (MHDC) per unit of low-income housing developed is high compared to other states in the Midwest. The state tax credit available, since 1997, has been up to 100% of the federal tax credit amount. Instead of doubling the amount of housing constructed in Missouri, it appears that the state credit has had little effect on the rate of construction of low income housing.

Oversight compared information regarding housing tax credits issued and units developed in Missouri and in thirteen other states for the years 1998 through 2000. None of the other states had a state tax credit program in place in this three year period, but the amount of federal tax credits issued per unit in Missouri during this period was comparable to the average of the other states studied. Total housing tax credits issued (state and federal) per unit in Missouri is roughly double that of the average in surrounding states.

Year	Average of other States	Missouri State Credit	Missouri Federal Credit	Missouri Total Credit
1998	\$5,474	\$4,968	\$5,114	\$10,082
1999	\$5,854	\$6,277	\$6,315	\$12,592
2000	\$5,873	\$5,694	\$5,700	\$11,394

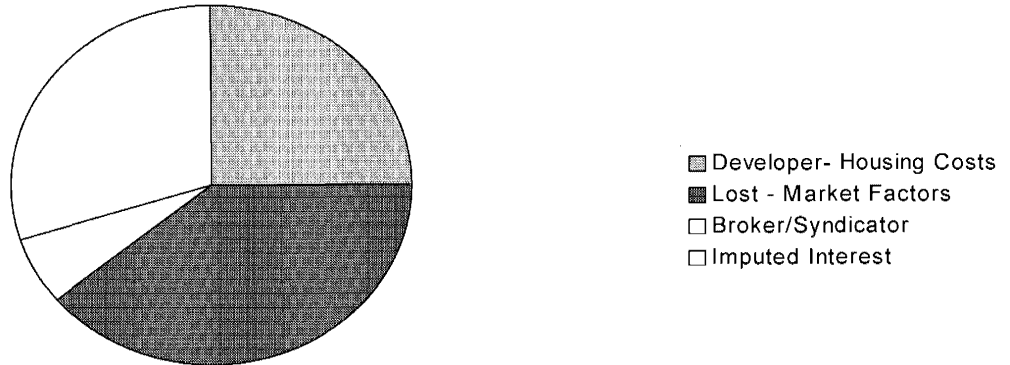
Based on the amount of tax credits issued, it seems that either MHDC issues substantially more tax credits per unit of housing compared to surrounding states, or that the Missouri housing tax credits do not add comparable value to a project. The Missouri Housing Development Commission is charged with issuing only enough federal and state housing tax credits to make a project viable.

MHDC staff states that the state credit has resulted in significantly lower monthly rents for tenants living in tax credit apartments. Further, MHDC staff stated that the state credit has allowed MHDC to support affordable housing in rural areas of the state with very low median incomes. Finally, MHDC staff states that the level of housing construction activity, particularly in rural areas, contributes significantly to the economic and job creation efforts of the state.

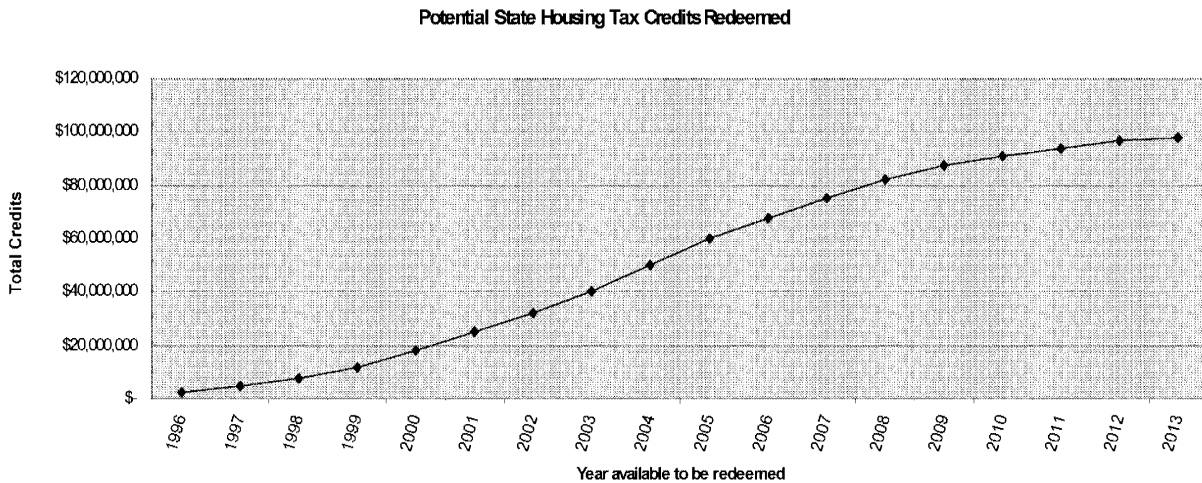
According to MHDC and a financial institution involved in marketing the tax credits, the federal credits are valued at roughly 70 cents on the dollar, while the state tax credits normally sell for 25 cents on the dollar. The state of Missouri is in effect paying whole dollars in tax credits for 25 cents in housing units.

The financial institution representative told us the market value of the state tax credits is relatively low because there are a limited number of potential buyers, and the housing tax credit is not competitive with other Missouri tax credits. The housing tax credit is more risky for potential buyers because of the potential for recapture and the need for a buyer to become involved in a limited partnership.

Outcome of State Housing Tax Credits



The potential impact on Missouri tax collections in the coming years is great. Expected redemptions are shown below, based on Oversight's assumption that tax credits are redeemed in the first year the credits are available and are not carried back or forward by investors. Annual redemption amounts will continue to grow as additional years tax credits and higher annual tax credit allocations are redeemed.



Oversight recommends the General Assembly consider the value the state housing tax credits bring to multifamily housing developments with the significant cost the credits will have on future tax collections. Consideration could be given to restructuring the state tax credit to obtain more housing for the amount of credits issued.

Comment: State agencies do not share and reconcile information regarding state tax credits, which is necessary to properly account for program costs.

The Missouri Housing Development Commission (MHDC) does not provide information to the Department of Revenue (DOR) regarding state low-income housing tax credits (state credits) issued in a given year or tax credit claims that may be redeemed in a given year.

The total tax credit amount which could be redeemed in a given year is the total for that year resulting from tax credits finally issued in the current and prior years. Only MHDC has accurate information on the amount issued by year. DOR was only able to give Oversight a summary of the tax credits redeemed. Since DOR does not have the amount of tax credits issued, DOR is not able to adequately monitor the utilization of the tax credit program, cannot verify the validity of tax credits claimed by taxpayers, and does not know how many tax credits may be claimed in a given year or how many are still outstanding.

DOR needs the ability to limit tax credit claims to legitimate tax credits. Further, the amount of issued but unclaimed credits is essential for planning purposes. MHDC and DOR should share information regarding the issuance and redemption of state housing credits. DOR should use this information to determine the total amount of tax credits that may be claimed by Missouri taxpayers in a given year, and MHDC should use this information to evaluate the effectiveness of state housing tax credits.

Oversight recommends the Missouri Housing Development Commission work with the Department of Revenue to create and implement a system that would allow for annual reconciliations of state housing tax credits issued by MHDC and used by Missouri taxpayers.

APPENDIX A

Multifamily Housing Project Basics

The Low Income Housing Tax Credit

The United States Congress created the Low Income Housing Tax Credit (Housing Credit) in 1986 as Section 42 of the Internal Revenue Code, because constructing and rehabilitating apartments costs too much to rent at rates that low income families can afford. According to the National Council of State Housing Agencies, approximately 100,000 low-cost apartments, far more than the Housing Tax Credit can replace, are demolished, abandoned, or converted to market rate use every year. The Housing Credit supplements approximately \$7 billion of private investment each year, to produce approximately 70,000 apartments with rents affordable to low income families and the elderly.

Housing Credit apartments also help stabilize neighborhoods by reducing the deterioration of existing housing stock, thereby improving overall housing quality and supply. Developments constructed or rehabilitated with tax credits are dedicated to low income housing for at least 15 years. Many developments are dedicated for periods longer than 30 years, and some are permanently dedicated to low income use.

The Housing Credit program provides a federal tax credit to investors in affordable housing. The credit can be used each year for 10 years and is available to developers, who then use the credit to raise equity to construct, or acquire and rehabilitate, affordable rental housing. The Internal Revenue Service allocates the credit each year to each state. The limit for federal housing tax credits in 2001 is \$1.50 times a state's population, and it increases to \$1.75 times state population in 2002. Beginning in 2003, the limit will be adjusted for inflation. The credit available to a development is limited to a percentage of the Qualified Basis, which is based upon depreciable basis, and on the percentage of affordable units in the development.

The minimum ratio of affordable units in a development is: a) 40% of the total number of units affordable to persons at 60% or less of the median income, or b) 20% affordable to persons at 50% or less of the median income. Rents are restricted, based on tenants' incomes, or available rent subsidies. In a 1997 study, the General Accounting Office found that average Housing Credit apartment tenants earn only 37 percent of the area median income. Many earn less than 30 percent.

Congress delegated the administration of the Low Income Housing Tax Credit to state housing finance agencies to assure that affordable housing is provided where it is most needed. The Missouri Housing Development Commission (MHDC) is Missouri's state housing finance agency. Missouri also has a state low income housing credit administered by MHDC, and MHDC may allocate a state tax credit up to 100% of the federal credit.

MHDC prepares the state's Qualified Allocation Plan (QAP), as required by the federal Housing Credit program. Those plans must give preference to developments serving the lowest income families and those serving low income families for the longest periods of time. The Qualified

Allocation Plan, which sets forth the selection criteria, federal preferences and the state's priorities for selecting developments, is revised annually. Each proposal is put through rigorous financial evaluations to make sure it receives only enough Housing Credits to make it viable. MHDC staff review proposed developments according to the established selection criteria, then rank the proposals for Commission approval.

MHDC is charged not only with the allocation of the Housing Credit, but also with assuring the development's compliance with federal regulations for at least the duration of the mandatory initial compliance period of 15 years, and longer if the property is subject to extended compliance requirements. MHDC reviews properties periodically, in accordance with federal requirements. The review includes a physical inspection of the property and a study of management and occupancy procedures. States must report noncompliance to the Internal Revenue Service, which can result in the eventual recapture of Housing Credits from noncompliant owners.

Limited Partnerships

The business entity of choice in the multi-family low-income housing development arena is the limited partnership. In most cases, a limited partnership will be created specifically for the purpose of owning the new housing development. The developer of the property is generally unable to use all of the tax benefits, such as depreciation and the Housing Credit, resulting from operation of the property. The limited partnership as a business entity allows the organization to provide disproportionate allocations among the partners of the partnership's transactions, a unique feature of partnerships. The partnership agreement generally determines a partner's share of any item or class of items of income, gain, loss, deduction, or credit.

A limited partnership also allows the developer of a multifamily housing property to generate cash for construction costs by accepting limited partnership investments from investors. In a typical case a specialist, or syndicator, forms yet another limited partnership and becomes its general partner. This second limited partnership only exists to maximize the value of the tax benefits available from the development. The syndicator then offers limited partnership interests to outside investors (who are in effect purchasing the depreciation deductions and tax credits) through a securities offering. These investors, in turn, are persons or entities who may have little or no working knowledge of the complexities of operating the development.

This ownership arrangement leaves the responsibility for management of the project with the developer or the syndicator, who have the expertise and resources to monitor the properties, as opposed to the limited partners who are typically inactive investors. Professional management is particularly significant for properties with syndicated ownership, since there are serious adverse consequences for investors in a failed development. If the property falls out of compliance with Section 42 requirements, a portion of the depreciation deductions and tax credits that have already been used may be reclaimed, and future years' tax credits already purchased by an investor may be disallowed. The syndicator provides financial and operating supervision to assure continued compliance with Housing Credit stipulations.

According to the MHDC, investors discount the stated value of the Federal Housing Credits available from a project by approximately 30 cents, to account for the fact that they must wait 10 years to fully utilize the credits. The state housing tax credits are discounted further because of their limited appeal to investors and a smaller population of potential buyers. The syndicator would retain a portion of the proceeds for their services and the remainder would go to the developer to help pay for construction costs. A more detailed discussion of the secondary market of Housing Credits is provided in the following section.

Secondary Market Factors for Tax Credits

A series of factors in the secondary market affects the value of Housing Tax Credits and therefore the amount of housing which can be developed using these credits. MHDC monitors conditions and practitioners in the housing tax credit market in order to properly compute the value attributed to tax credits in the financing package for a proposed development. In addition, Oversight believes MHDC supervision would tend to improve stability in the market. It appears the number and amount of state housing tax credits in Missouri is not sufficient to create a large and active resale market. There may only be one active seller of Missouri housing tax credits. Further, tax credits are marketed to and used by a very limited number of sophisticated investors who value the tax credits according to their individual investment requirements.

As we have discussed above, the federal Housing Tax Credits are discounted by approximately 30% to account for the net present value of the ten-year credit availability and the risk of recapture if the project were to fall out of compliance with Section 42 requirements. The state Housing Tax Credits are discounted by approximately 70%, since they have all of the risks involved with the federal credits and these additional market factors:

A smaller number of potential buyers for state tax credits in general. The federal credits would have a national market but the state credits would be useful only to entities having Missouri taxes due.

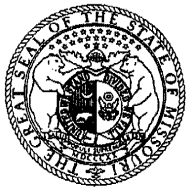
A large number and amount of state tax credits available in Missouri. Tax credits are available from a variety of state programs.

General concerns about limited partnerships among potential buyers. Some entities may have concerns about continued involvement in a limited partnership, and other Missouri tax credits can be sold directly without the need to use limited partnerships in their distribution.

Perceived complexity and relative risk as compared to other tax credits. Other Missouri tax credits are not subject to recapture during an extended mandatory compliance period.

The structure of the Missouri Housing Tax Credit creates inherent risk factors, which investors consider when evaluating a potential tax credit purchase. These factors place the Missouri housing tax credit at a significant disadvantage relative to other Missouri tax credit programs and therefore limit the usefulness of the credit in producing housing.

APPENDIX B



MISSOURI HOUSING DEVELOPMENT COMMISSION

January 18, 2002

COMMISSION

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JOE MAXWELL
Lieutenant Governor

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Mr. Mickey Wilson, CPA, Acting Director
Oversight Division
Committee on Legislative Research
State Capitol, Room 132
Jefferson City, Missouri 65101-6806

RECEIVED

JAN 23 2002

Dear Mr. Wilson:

Thank you for providing us with this opportunity to formally reply to the program evaluation performed by the Oversight Division.

Comment: MHDC development opportunities appear to be limited to developers with experience in the state.

MHDC response: State finance agency rental production programs, in large part driven by IRS tax credits, are extremely complex. Many developers who propose developments to MHDC are not experienced in these rules. Because timeframes are rigid, it is important to work with partners who are able to produce housing within specified time periods.

In FY 2000, MHDC provided funding to 23 developers in response to our notice of funding availability. In FY 2001, 26 developers were provided funding.

Please note that MHDC staff is eager to work with developers who seek to do business with the Commission. Annually the Qualified Allocation Plan is sent to 1,500 builders, developers and other housing professionals nationwide. Notices of funding availability are published in 80 newspapers throughout the state and statewide public hearings are conducted regarding the Allocation Plan. In addition, MHDC staff meets routinely with developers interested in providing affordable housing in the state in an effort to increase participation by new entities.

Comment: MHDC is using most of its proceeds from tax-exempt bonds for investment in securities rather than funding for its program.

MHDC Response: Please note that the comment regarding marketable securities should, in fact, refer to mortgage-backed securities. This is important because it is an indication that the Commission does invest its funds in housing programs.

Early in MHDC's history, proceeds from the sale of MHDC bonds went directly into mortgages. Over the life of the mortgage and bonds, revenue (principal and interest) flows from the mortgages to the bondholders. These are known as "revenue" bonds. The mortgages were FHA insured or VA guaranteed and in the case of default, this underlying insurance or guarantee would provide funds (on a delayed basis) to redeem the bonds. Because of the delayed flow of funds in the case of default, reserves were necessary to insure that the funds would be available when it came time to redeem the bonds. For a number of reasons; MHDC strength, FHA insurance or VA guarantee and the reserves that were established, the bonds that were issued under these conditions received a AA rating from the rating agencies. MHDC strength along with the AA rating provided a comparable good interest rate when the bonds were sold and we were able to pass this good rate along to first-time homebuyers in Missouri.

During the middle 1980's a new bond structure came to be used by MHDC. The mortgages were still FHA insured or VA guaranteed and in some cases were privately insured. However, at that point, the mortgages were accumulated into GNMA or FNMA pools. These mortgage-backed securities representing the GNMA and FNMA pools were delivered and held by Trustee for the bondholders. The Commission is still making mortgage loans as it always was, but, by placing the loans in a GNMA or FNMA pool, the asset or collateral for the bond issue is now a mortgage-backed security rather than an individual loan and is shown as such on our financial statements. Since the Trustee is now holding mortgage-backed certificates for GNMA or FNMA pools which are guaranteed for payment, it is no longer necessary to hold reserves to draw on to make scheduled payments or to redeem bonds.

For all of the reasons noted in the first paragraph plus the guarantee of payment of the GNMA and FNMA mortgage-backed certificates, the Commission now receives a AAA rating from the rating agencies and an even better comparable interest rate when the bonds are sold. We are able to pass this savings along to Missouri homebuyers in the form of even lower interest rates.

Since the reserves are no longer necessary and since MHDC advances all of the cost of issuing the bonds, 100% of the bond proceeds are invested in mortgages. The only time that bond proceeds are placed in investments will be for that relatively short period of time commencing when the bonds are sold and delivered and ending when the GNMA or FNMA mortgage-backed certificates are delivered to the Trustee.

As to receiving funds from early payment of the mortgage loans, any accumulation of cash by MHDC is short term since we are required by the terms of our bond documents to redeem bonds at the earliest possible date, which is usually every six months.

Comment: The Commission's large fund balances suggest its charges have been exceeding its costs and should be reduced.

The Commission has been able to accumulate fund balances of some \$287 million over the 30 years that we have been in existence. **These fund balances have not only enabled us to better fulfill our mission to meet the affordable housing needs of the citizens of Missouri, but without them, MHDC would simply NOT be able to offer the successful programs that we have available today.**

It has enabled us to restrict almost \$37 million of funds by bond resolution, thereby reassuring the rating agencies that we can stand behind our bond issues should the need arise. This also ensures that MHDC bonds sell at a favorable rate, enabling the Commission to offer mortgages at a favorable interest rate to first-time homebuyers.

In our Rental Assistance Payments program, we have been able to set aside over \$46 million of investments so that the earnings can be used for rental assistance payments for very low-income families.

Approximately \$7 million is restricted for the Missouri Housing Trust Fund. These are not the Commission's funds. The Commission is directed by statute to administer these funds in accordance with provisions of that statute. These funds will be committed based upon applications received and will be expended during the coming year.

In previous years the Commission funded interest subsidy for certain loans that served low-income families. We have almost \$6 million of fund balances set aside to provide the funding for this program over the life of the loans.

In 1996, the Commission acquired a portfolio of 26 HUD loans, paying a nominal amount for these loans. A condition of this purchase was that the developments are to be retained for low-income persons and families and all income derived from the loans is to be used for the rehabilitation of the developments and for the benefit of the tenants.

MHDC sells a number of new bond issues every year to raise money to finance the construction or acquisition of rental housing and homeowner mortgage loans. In order to use all of the bond proceeds to fund mortgage loans, the Commission provides funds to pay for costs incurred during the process of issuing the bonds. MHDC has used over \$22 million of fund balances for this purpose.

Our largest use of fund balances has been to make loans that are not funded by a bond sale. All of these loans are for low and moderate-income families. A number of loans provide housing for the homeless and among an assortment of other programs, the Commission provides funding for Habitat for Humanity so their limited funds can be recycled into more housing. We have expended \$116 million of the Commission's funds balances in these efforts.

Every year we analyze our unrestricted fund balances and, in response to proposals received, commit to making additional loans for low-income families. We have almost \$15 million committed to this program.

Included in fund balances are funds required by accounting rules and procedures (compliance with the requirements of GASB Statement No. 31 which requires "Fair Market Valuation" is a major item). These adjustments have increased fund balances by approximately \$16 million and will fluctuate in the future according to market conditions.

This leaves an unrestricted fund balance of approximately \$15 million. Yearly the Commission adopts a budget for the next year and commits our unrestricted fund balances to new or continuing programs. In May 2002 a major portion of the \$15 will be committed when the budget is adopted.

Comment: The Commission discards records which could document their decisions.

MHDC Response: Effective immediately, a copy of each proposal presented to the Commission will be stored for a year after the pertinent funding decision has been made.

Comment: State Tax Credits for low-income housing appear to have little effect on the program while costing the state a rapidly increasing amount of tax revenue.

MHDC Response: **Although use of the state Low Income Housing Tax Credit may not appear to increase the number of affordable rental units, its use has a tremendous effect on the affordability of these units. In 2001 MHDC estimates the total development costs for all rental housing development to be approx. \$231 million. This level of housing construction activity contributes significantly to the economic development and job creation efforts of the state.**

MHDC staff finds that it takes MHDC financing at 1% interest, as well as state and federal Low Income Housing Tax Credit, to build housing that is affordable to very low-income families. Staff also finds that a number of states may not consider affordability as important an issue as it is to the Commission. It is our mission to serve Missourians at very low-income levels, and due in large part to the state tax credit, the Missouri Low Income Housing Tax Credit program serves renters well below the 50% of the median income that is required by the IRS regulations.

This is especially true in rural Missouri communities where the median income necessitates rents as low as \$280 a month for one-bedroom units and \$320 for three-bedroom units. These rents are not achievable without the equity brought by the state credit. Other states are not able to provide housing in more rural areas, nor at rents affordable to renters with incomes below 50% of the median income.

In fact, unlike many other states, MHDC staff is able to ensure (in great part by use of the state credit) that rents at developments underwritten by MHDC are not higher than HUD's "Fair Market Rents". This allows Section 8 Voucher holders, many of whom have incomes lower than 30% of the Fair Market Rents, to live at tax credit-financed developments. This is not possible in states without the state housing credit.

MHDC staff has calculated that rents would increase \$89 per renter per month without the use of the state credit, thus pricing the affordable units out of the range of the many truly needy Missourians.

Please note that there are developers in the state who believe that the state credit could immediately be made more valuable with a change in the recapture provision of the law. If a passive investor is not penalized if a development were to fail through no fault of that investor, we have been told that the value might increase by as much as \$.015 per credit. Importantly no development underwritten by MHDC has ever had a failure that resulted in a recapture of tax credit.

Comment: State agencies do not share and reconcile information regarding tax credits, which is necessary to properly account for program costs.

MHDC Response: Each February, MHDC staff sends to the state Department of Revenue the original Missouri Eligibility Statements that were issued for the previous year. It is important to note that staff tracks the tax credits allocated in a given period, but does not have information about credits claimed. This is due to the law permitting the taxpayer to carry forward (or carry back) the credit for a number of years.

If asked, MHDC staff would be happy to provide an aggregated report to the state DOR similar to that which is provided to the IRS, noting the total amount of state credit issued for the year.

If you have any questions regarding any of our responses, please don't hesitate to let me know.

Sincerely,



Erica A. Dobreff
Executive Director